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IN THE

SUPREME COURT OF THE UNITED STATES

MAR 4

OCTOBER TERM, 1941

NO. 10-439

CHICAGO, TERRE HAUTE AND SOUTHEASTERN
RAILWAY COMPANY, *et al.*,
Petitioners,

vs.

GROUP OF INSTITUTIONAL INVESTORS, *et al.*,
Respondents.

**PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES CIRCUIT COURT OF
APPEALS FOR THE SEVENTH CIRCUIT
AND BRIEF IN SUPPORT THEREOF.**

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March 2, 1942

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APPEALS FOR THE SEVENTH CIRCUIT.**

*To the Honorable the Chief Justice and the Associate
Justices of the Supreme Court of the United States:*

Your petitioners respectfully show:

**SUMMARY STATEMENT OF THE
MATTER INVOLVED**

This is a proceeding for the reorganization of a railroad under section 77 of the Bankruptcy Act (11 U. S. C. A. §205). The debtor, Chicago, Milwaukee, St. Paul and Pacific Railroad Company, filed its petition for reorganization on June 29, 1935, with the District Court of the

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United States for the Northern District of Illinois (R. 2), and on the same day the District Court approved the petition as properly filed (R. 42). Subsequently, the Interstate Commerce Commission approved and certified to the District Court (R. 243, 245) a plan of reorganization (R. 1319-1347). The District Court entered an order approving the plan and overruling petitioners' objections thereto (R. 1978-1992)¹. Petitioners appealed to the Circuit Court of Appeals for the Seventh Circuit (R. 2016), which reversed the District Court, with directions to set aside the order and remand the case to the Interstate Commerce Commission (R. 2321-2322). This petition is filed because of a possible construction of the judgment of the Circuit Court of Appeals which is adverse to these petitioners.

The fundamental question presented by this petition is whether the rejection of a railroad lease in the reorganization of the lessee must take effect by relation as of the date of the filing of the debtor's petition, rather than as of a date long subsequent to the beginning of the proceeding. The issue involved relates only to the rights of the lessor upon rejection of the lease. It in no way deals with, and is not affected by, the treatment to be accorded creditors of the debtor in the readjustment of their claims.

Petitioner Chicago, Terre Haute and Southeastern Railway Company (hereinafter referred to as the "Terre Haute") is a railroad corporation organized in the year 1910 under the laws of the State of Indiana and is the owner of approximately 360 miles of railroad extending from Chicago Heights, Illinois, to Westport, Sullivan and Oolitic, Indiana (R. 1861, 2163-2164). It is not

¹ Petitioners' objections appear at R. 1373, 1393, 1414, 1434, 1438, 1465, 1477, 1480, 1901-1903.

a debtor in this proceeding, nor is it in bankruptcy reorganization or any state or federal receivership (R. 1876, 2158). Its presence in this proceeding arises out of the fact that it is the lessor of a line of railroad to the debtor and the further fact that the reorganization plan approved by the Interstate Commerce Commission and the District Court proposed to reject the present lease and to offer for the acceptance of the Terre Haute and its bondholders a new lease on prescribed terms (R. 1330-1331). Petitioners other than the Terre Haute are the trustees under the four mortgages securing Terre Haute bonds², two protective commit-

² Mercantile National Bank of Chicago and Benjamin H. Rubenzik, trustees under the mortgage securing the Bedford Belt Railway Company First Mortgage 5% bonds, due July 1, 1938, constituting a first mortgage on 4.66 miles of the Terre Haute lines. \$250,000 principal amount of bonds are outstanding. (R. 2169.)

Girard Trust Company, trustee under the mortgage securing the Southern Indiana Railway Company First Mortgage 4% bonds, due February 1, 1951, constituting a first mortgage on 240.92 miles of the Terre Haute lines and a second mortgage on the property subject to the Bedford Belt mortgage. \$7,287,000 principal amount of bonds are outstanding. (R. 2169-2170.)

Continental Illinois National Bank and Trust Company of Chicago, trustee under the mortgage securing Chicago, Terre Haute and Southeastern Railway Company First and Refunding Mortgage 5% bonds, due December 1, 1960, constituting a first mortgage on 115.17 miles of the Terre Haute lines and a junior mortgage on the properties subject to the Bedford Belt and Southern Indiana mortgages. \$8,056,000 principal amount of bonds are outstanding. (R. 2169-2170.)

The First National Bank of Chicago, trustee under the mortgage securing Chicago, Terre Haute and Southeastern Railway Company 5% Income Mortgage Bonds, due December 1, 1960, constituting a junior mortgage on the properties subject to the First and Refunding Mortgage. \$6,336,000 principal amount of bonds are outstanding. (R. 2169-2170.)

tees for holders of Terre Haute bonds³, and two insurance companies owning Terre Haute bonds⁴.

On July 1, 1921, the Terre Haute leased its entire property for a term of 999 years to the Chicago, Milwaukee and St. Paul Railway Company, the predecessor of the debtor herein (R. 2163). The lessee agreed to pay an amount equal to the interest on the bonds of the Terre Haute⁵, the principal of such bonds at maturity, the expense of maintaining the Terre Haute's corporate existence (not in excess of \$12,000 a year), and all taxes, and also agreed to perform the covenants of the Terre Haute bonds and mortgages and to maintain and replace the Terre Haute equipment⁶. On

³ Terre Haute First Lien Bondholders Committee, representing \$1,704,000 principal amount of the First and Refunding bonds, \$804,000 principal amount of the Southern Indiana bonds and \$31,000 principal amount of the Bedford Belt bonds (R. 1716); and Terre Haute Income Mortgage Bondholders' Committee, representing at the time of the District Court hearing \$199,100 principal amount of the Income Mortgage bonds (R. 1719), and at the present time \$822,900 principal amount.

⁴ Massachusetts Mutual Life Insurance Company, owner of \$200,000 principal amount of the Southern Indiana bonds and \$500,000 principal amount of the Income Mortgage bonds (R. 1439); and The Prudential Insurance Company of America, owner of \$500,000 principal amount of the First and Refunding bonds and \$500,000 principal amount of the Income Mortgage bonds (R. 1719).

⁵ Annual interest requirements aggregate \$1,023,580 (R. 2169).

⁶ The lease was introduced in evidence before the Interstate Commerce Commission as Debtor's Exhibit 63 (R. 283). Such exhibits, and the exhibits introduced in evidence before the District Court, are a part of the record, but are not included in the printed transcript.

Under the terms of the lease the Terre Haute is required, upon its termination, to repay the amount of principal payments made by the lessee, but such repayment may be made in bonds of the Terre Haute at par.

January 14, 1928, the debtor acquired the properties of the lessee in connection with the reorganization of that company and adopted the lease pursuant to authorization granted by the Interstate Commerce Commission in *Chicago, Milwaukee & St. Paul Reorganization*, 131 I. C. C. 673, 700 (R. 2162-2163).

Since the institution of this proceeding the debtor and its trustees, who took office on January 1, 1936, have held possession of and operated the Terre Haute properties (R. 2156), but have not elected either to adopt or reject the lease (R. 1510). Orders entered by the District Court have from time to time extended the time within which such election might be made (R. 46, 84, 91, 121, 144, 164, 197, 198, 210, 232, 1351), and have enjoined all persons from interfering with, disturbing or taking possession of any portion of the assets, railroads or properties in the possession of the debtor or its trustees (R. 48, 80). During this period the current interest on the Terre Haute bonds has been paid (R. 2169) pursuant to an order of the District Court which provides that it shall not affect the right to disaffirm the lease (R. 75), but the provisions of the lease requiring payment at maturity of the principal of the Terre Haute bonds⁷ and replacement of Terre Haute equipment⁸ have not been performed (R. 193, 2170).

⁷ The District Court ordered the debtor's trustees not to pay the principal of the Bedford Belt bonds at their maturity on July 1, 1938, but to continue interest payments thereon (R. 193).

⁸ As of the date of the filing of the debtor's petition (June 29, 1935), defaults with respect to the obligation to replace retired equipment amounted to approximately \$5,000,000, and as of December 31, 1937, the amount of these equipment vacancies had increased to \$7,106,149. (R. 2170.) During the period from July 1, 1935, to June 30, 1940, there were retired and not replaced 896 units of equipment, including one steam locomotive, 718 coal cars and 151 flat cars. (Terre Haute District Court Exhibit 24, introduced at R. 1688-1689.)

The reorganization plan approved by the Interstate Commerce Commission and the District Court proposes the making of a new lease upon terms more favorable to the lessee than those of the present lease, with corresponding modifications of the Terre Haute bonds and mortgages⁹. Acceptance by the Terre Haute bondholders of the proposal is a prerequisite to the making of such a new lease, since neither the Interstate Commerce Commission nor the court has jurisdiction in this proceeding to impose the proposed modifications upon the lessor and its bondholders against their will. Recognizing this, the plan provides that after confirmation by the District Court the proposal shall be submitted to the Terre Haute bondholders for acceptance or rejection. It further provides that if the court thereafter determines that the proposal has not been accepted by substantially all of those bondholders the existing lease "shall be rejected, in so far as the plan herein approved is concerned, *as of the date of such determination by the court.*" (Italics ours.) (R. 1330-1331.)

⁹ The proposal consists of extension of all bond maturities to July 1, 1989; reduction of all bond interest to 2 $\frac{3}{4}$ % per annum fixed and 1 $\frac{1}{2}$ % per annum contingent (the contingent interest being payable on the basis of system income only after payment of all fixed charges of the reorganized company and appropriation of \$2,500,000 annually for capital expenditures); waiver of all equipment vacancies to July 1, 1939, and modification of the covenants relating to replacement of equipment retired in the future; nullification of the Milwaukee's guarantee of the Terre Haute Income Mortgage Bonds; the making of provision to permit abandonment of Terre Haute property when to the advantage of the Milwaukee system; and the making of provisions to facilitate the consolidation of the Terre Haute properties with those of the Milwaukee. (R. 1330-1331.)

This provision that the rejection of the lease shall take effect as of a future date would require that the lessor's claim for damages for breach of the lease be measured as of that date and that the operation of the leased lines from the beginning of the reorganization proceeding until that date be for the account of the debtor's estate rather than for the account of the lessor.

Petitioners objected to this feature of the plan in the District Court because of its violation of the established principle that rejection of a railroad lease in reorganization takes effect as of the date of the institution of the reorganization proceeding, that damages for the breach are measured as of that date, and that the operation of the leased line after that date is for the account of the lessor, which is chargeable with all losses and entitled to any profits. In its order approving the plan the District Court overruled petitioners' objections (R. 1990).

On appeal to the Circuit Court of Appeals petitioners attacked this ruling and on that ground, among others, sought reversal of the District Court's order of approval (R. 2025, 2031-2032). The opinion of the Circuit Court of Appeals makes no reference to this issue. Its judgment, so far as material, reads as follows (R. 2321-2322):

“ • • • it is ordered, adjudged and decreed by this Court that the order or decree of the said District Court in this cause appealed from be, and the same is hereby, reversed, and that this cause be, and it is hereby, remanded to the said District Court with directions to set aside the District Court's order of approval and to remand the case to the Interstate Commerce Commission for the making of findings, and, if necessary, the taking of additional evidence, that additional findings may be made, as indicated in the opinion of this Court filed herein; and that each party will pay its own costs in this Court.”

On its face this judgment is favorable to petitioners, as the reversal of the order of the District Court constitutes the ultimate relief which they sought. The judgment, however, directs the District Court to remand the case to the Interstate Commerce Commission for the making of findings, and, if necessary, the taking of additional evidence, that additional findings may be made. It does not direct that rejection of the lease, if it occurs, must take effect as of the date of the institution of the proceeding, and it might be contended that as a result of this silence the judgment is adverse to petitioners on that issue. While we believe that such a construction of the judgment would be erroneous, we recognize that it is possible, and this petition is filed to review the judgment if it is so construed¹⁰.

STATUTE INVOLVED

The pertinent provisions of section 77 of the Bankruptcy Act (11 U. S. C. A. § 205) are reproduced as an appendix, *infra*, page 22.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 4, 1941 (R. 2318, 2321-2322). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A. § 347).

¹⁰ The alternative construction of the judgment is dealt with in the brief filed contemporaneously herewith by these petitioners in opposition to the Petition of Group of Institutional Investors and Mutual Savings Bank Group for Writs of Certiorari, Nos. 875-883.

QUESTIONS PRESENTED

1. May a plan of reorganization for a lessee of a line of railroad, which provides for rejection of the lease, lawfully require that the rejection shall take effect as of a date other than, and subsequent to, the date on which the reorganization proceeding was instituted?
2. May such a plan lawfully require that the lessor's claim for damages shall be measured as of a date other than the date on which the reorganization proceeding was instituted?
3. May such a plan lawfully require that the operation of the leased property shall be for the account of the debtor's estate, rather than for the account of the lessor, after the date on which the reorganization proceeding was instituted?

**REASONS RELIED ON FOR THE ALLOWANCE
OF THE WRIT**

This petition is filed to review the judgment below if construed as decreeing that the plan of reorganization may provide that rejection of the lease shall take effect as of a date subsequent to the date on which the proceeding was instituted. The following statement of reasons relied on for the allowance of the writ assumes that the judgment is properly so construed. The reasons are:

- (1) The judgment, if so construed, decides a question as to the construction of the federal Bankruptcy Act with respect to the measure of the lessor's claim for damages in a way probably in conflict with the decision of this Court in *Connecticut Ry. Co. v. Palmer*, 305 U. S. 493.

(2) The judgment, if so construed, decides a question under the federal Bankruptcy Act with respect to the right to net earnings and the liability for losses from operation of the leased line during the proceeding in a way probably in conflict with the decision of this Court in *Palmer v. Webster & Atlas Bank*, 312 U. S. 156.

(3) The judgment, if so construed, is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *Palmer v. Palmer*, 104 F. (2d) 161, with respect to the right to net earnings and the liability for losses from operation of the leased line during the proceeding.

WHEREFORE, your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the Circuit Court of Appeals for the Seventh Circuit, commanding that court to certify and send to this Court for its review and determination, on a date certain to be therein named, a full and complete transcript of the record and of all of the proceedings in the case numbered on its docket No. 7614 and entitled "In the Matter of Chicago, Milwaukee, St. Paul & Pacific Railroad Company, Debtor; Chicago, Terre Haute & Southeastern Ry. Co., Income Mortgage Bondholders' Committee, et al., Appellants, vs. Group of Institutional Investors, etc., et al., Appellees," and that the judgment herein of said Circuit Court of Appeals for the Seventh Circuit be modified and the case remanded with directions to instruct the Interstate Commerce Commission that rejection of the Terre Haute lease, if it occurs, must take effect as of the date of the institution of the reorganization proceed-

ing, and that your petitioners may have such other and further relief in the premises as to this Court may seem proper.

Dated March 2, 1942.

Respectfully submitted,

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